Futures Industry Association
2001 Pennsylvania Ave. NW
Suite 600
Washington, DC 20006-1823

202.466.5460
202.296.3184 fax
www.futuresindustry.org

January 3, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Provisions Common to Registered Entities – 75 Fed. Reg. 67282 (November 2, 2010)

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] is pleased to submit this letter in response to the request for comment with respect to the rules that have been proposed by the Commodity Futures Trading Commission (the "Commission") to implement the statutory framework for the certification and approval of new products, rules and rule amendments that are submitted to the Commission by derivatives clearing organizations ("DCOs"), designated contract markets ("DCMs"), swap execution facilities ("SEFs") and swap data repositories ("SDRs"; collectively, "registered entities").

In general, FIA believes that the Commission's proposal appropriately implements the new statutory framework for the certification and, as appropriate, Commission's approval of rules, rule amendments and new products by the registered entities. FIA believes strongly, however, that the Commission should take this opportunity to remedy a defect in the scheme of self-regulation that allows the registered entities to certify rules without the knowledge and participation of their members and other interested market participants.

The process by which the DCMs and DCOs adopt rules and rule amendments and approve new products for trading and clearing has historically been conducted without the participation of member firms or other market participants, and FIA anticipates that SEFs and SDRs will operate similarly. In practice, the decision to adopt or modify rules, or to list or clear new products, is almost invariably made by the board of the registered entity or a committee thereof, and members and market users typically learn that a rule has been adopted or amended, or a new

[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among FIA's associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

product has been approved, only after the registered entity has self-certified the rule or product submission to the Commission.

FIA has previously expressed the view that the procedures by which a registered entity adopts its rules "should be transparent and should assure that members and other market participants, not just one constituency, have an opportunity to express their views and otherwise participate in the process."[2] FIA recognizes that the Commission may be reluctant to require the registered entities to modify their internal procedures.[3] FIA accordingly believes that the Commission should use this opportunity to increase the transparency of the rulemaking processes of the registered entities by taking the following, relatively simple steps to ensure the widespread and timely availability of information to the members and users of the registered entities.

> *First*, the Commission should publish a daily consolidated notice of all rule and product filings by the registered entities and all actions taken by the Commission in response thereto (such as approvals and stays of self-certifications), similar to the daily News Digest that is published daily on the Web site of the Securities and Exchange Commission ("SEC").[4] Doing so would allow the Commission promptly to disseminate this information efficiently and inexpensively to members of the registered entities and other market participants. Given the limited amount of time that the Commission has to review a rule or a product that has been self-certified by a registered entity under Section 5c(c) of the Commodity Exchange Act, the Commission would need to take steps to ensure that the daily digest reflects all rule filings made on the prior business day by any of the registered entities.[5]
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> *Second*, and related to the preceding, FIA further recommends that the Commission require the registered entities to include, in the forepart of each rule submission, a concise explanation (15-35 words would likely be sufficient) of the operation, purpose and effect of the proposed rule or rule amendment and that the Commission publish that explanation in the daily digest, together with a hyperlink to the full text of the rule submission on the

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[2] September 30, 2004 letter from John M. Damgard, President, FIA, to Jean A. Webb, Secretary of the Commission re Governance of Self Regulatory Organizations, 69 Fed. Reg. 32326 (June 9, 2004), at 5.

[3] The Commission recently proposed rules that would require the boards of directors and certain committees of DCOs, DCMs and SEFs to include independent directors and public representatives. *See* 75 Fed. Reg. 63732 (October 18, 2010). FIA has expressed strong reservations about certain aspects of that proposal. *See* November 17, 2010 letter from John M. Damgard, President, FIA, to David A. Stawick, Secretary of the Commission. FIA's concerns about the timely availability of information about pending rules would not be addressed by that other rulemaking, even if those rules were adopted as proposed by the Commission, because board and committee members are required to maintain the confidentiality of information that they receive in those capacities. Thus, changing the composition of a registered entity's decision-making bodies will not result in the dissemination of information about board and committee decisions to the registered entity's membership or to other users of the market or clearinghouse.

[4] *See* http://www.sec.gov/news/digest/2010/dig122010.htm (December 20, 2010).

[5] We are suggesting that the Commission begin a daily publication containing this information in lieu of a request that the rules be published in the Federal Register as is the practice for similar rules in the securities industry. Congress has provided an extremely short amount of time for the Commission and industry participants to review these rules under Section 5c(c). Immediate notice is, therefore, a far superior alternative to waiting several days for Federal Register publication of the rule or product filing.

Commission's Web site.[6] Adoption of this recommendation would be helpful to the Commission, as well as to FIA member firms and the public, in that it would require the registered entities to identify with specificity the substance of a given proposal, thereby allowing Commission staff and interested members of the public to determine quickly, without downloading and parsing through the registered entity's entire rulebook, whether the proposed rule or rule amendment raises issues of concern under the Act, including the relevant Core Principles, or Commission regulations.[7]

Adoption of these two, relatively simple measures will help ensure that members of the registered entities and other market participants are given a meaningful and timely opportunity to review pending rule filings and identify for the Commission's benefit aspects or consequences of a proposed rule or rule amendment that are not apparent from the text of the rule itself.[8] FIA believes that adoption of the first of these steps would entail nothing more than the most nominal cost to the Commission, consisting almost entirely of the daily collection of the registered entities' summaries from the specified portion of their rule filings and the collation of that information for publication in the Commission's daily digest. FIA further believes that requiring a registered entity to summarize its submission would impose no burden on the registered entities, other than the need to respond meaningfully to the views of their members and other market participants who are not now given the opportunity to comment on rule changes until after they have become effective.

FIA is aware that implementation of these proposals could have the effect of increasing public participation in the rule review process and, in turn, creating more work for an already-burdened Commission staff. FIA would respond to that concern by noting that the responsibilities of the registered entities, of market participants and of the Commission itself have been changed in fundamental respects by the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Stated differently, the DCMs and DCOs are now permitted to trade and clear products that were, prior to the passage of Dodd-Frank, largely outside the Commission's purview. The Commission and its staff are accordingly being asked to respond to challenges that are in some cases well outside the Commission's areas of recognized expertise. Taking steps to draw upon the vast experience and resources of market participants and other interested parties, therefore, can only help the Commission sharpen its analysis and identify issues of concern before the rules in question have been implemented.

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6 The brief summaries that are published in the SEC News Digest are taken directly from the rule filings that are made by the securities self-regulatory organizations. In fact, the SEC form that is used for the filing of rule changes by the securities self-regulatory organizations directs the filing entity to "[s]upply a brief statement of the terms of substance of the proposed rule change," which is then followed by a more thorough statement of the purpose of, and statutory basis for, the proposed rule change. *See* http://www.sec.gov/about/forms/form19b-4.pdf, at 18-19 (PDF pages 20 and 21).

7 FIA appreciates that the Commission already publishes the registered entities' rule filings on its Web site. In practice, this requires interested persons to download and review each such rule filing simply to determine if it merits further discussion and analysis. Adoption of our proposal would make that unnecessary, because it would provide a succinct description of the action that is proposed to be taken by the registered entity.

8 FIA envisions that the Commission would make clear that a summary description that does not fairly describe the operation, purpose and effect of the proposed rule or rule amendment, or that omits information that could reasonably be deemed to be important by the Commission, members of the registered entity or market participants will be deemed to be grounds for a stay of the rule review process under Commission Regulation 40.2 or Commission Regulation 40.6.

The industry's experience with Clearport is illustrative. The New York Mercantile Exchange ("NYMEX"), confronted with concerns about the additional risks posed by the clearing of over-the-counter ("OTC") products, developed a plan to use its guaranty fund to pay losses to futures customers resulting from the failure of a clearing member that had cleared OTC products. This was, at the time, unlike anything that had ever been done in the futures industry – not only was NYMEX seeking to use its futures guaranty fund to cover OTC losses, it was also proposing to use it directly to reimburse customers, something which to FIA's knowledge has never been done (before or since) by any of the DCOs. NYMEX abandoned its plan in the face of strong opposition from its clearing members when word of its proposal leaked out, but the fact of the matter is that, under the Commission's proposal, NYMEX could have certified its rule and made it effective without the Commission having had the benefit of the dissenting views of clearing members and other interested parties.[9]

The adoption of FIA's recommendation would lessen the risk that a DCO will, in the future, be able to self-certify rules that fundamentally alter the financial responsibilities of clearing members and, by extension, the rights of customers. Applicants for clearing membership typically engage in a careful analysis of the risks that are associated with membership in a particular clearing organization. An important part of this analysis is a careful evaluation of the risk "waterfall" that is embedded in the DCO's rules, with special emphasis on any limits on the ability of the DCO to assess its clearing members to cover the cost of a default. FIA, therefore, is concerned that matters involving fundamental changes to a DCO's rules affecting the management and allocation of risk, including the DCOs' guaranty fund requirements, loss "waterfalls" and assessment powers, could be self-certified by a DCO, without meaningful input from clearing members or their customers as long as the rules in question are not inconsistent with the Act. In such circumstances, the Commission would have a mere ten business days in which to evaluate the submission (and the views of interested parties) and, if appropriate, take the steps that are required to stay the certification.

FIA accordingly recommends that the Commission exercise its authority under Sections 5b(c)(2)(A) and 8a(5) of the Act to provide that DCO rules relating to certain highly sensitive subjects – specifically, a DCO's risk waterfall, guaranty fund requirements or assessment powers – will be deemed to be "novel or complex" within the meaning of Section 5c(c)(2) of the Act and, therefore, will be automatically subject to the stay of self-certification provided in Section 5c(c)(2). Taking this step would ensure that the Commission has the time that it needs (up to 90 days, unless extended by the DCO) to carefully evaluate this limited set of rules that are vital to the financial integrity of clearinghouses and to the willingness of clearing members to risk their capital in support thereof.

FIA additionally would like to offer the following suggestions to further improve the Commission's proposal:

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[9] This is not an isolated occurrence. To cite just one other example, the Chicago Board of Trade ("CBOT") and Chicago Mercantile Exchange ("CME") submitted rules in 2003 (well before the merger of the two exchanges) for the unprecedented transfer of the open interest for all CBOT contracts from the CBOT's longstanding DCO to the CME Clearing House. The CBOT and CME rules were submitted from June 3-26, 2003. The Commission provided what was, in effect, a three-day public comment period before approving the rules on July 15, 2003, based upon representations from the CBOT and CME that time was of the essence. The CBOT did not begin clearing at the CME, however, until January 2, 2004.

- Proposed Regulation 40.10(a) would require a systemically important DCOs ("SIDCO") to describe, in addition to the information that is required of all DCOs under Regulation 40.6(a)(7), the nature of the rule change, the expected effect on risks to the SIDCO, its clearing members and the market, and how the SIDCO planned to manage those risks. FIA believes that an evaluation of these factors should be required of all DCOs (and not merely SIDCOs). FIA accordingly recommends that all DCOs be required to include this information in their submissions to the Commission and that Regulation 40.6(a)(7) be amended accordingly.

- The Commission has specifically requested comments on whether there any substantive changes to rules, procedures, or operations that should not be permitted to be adopted under emergency circumstances without prior notice to the Commission.[10] FIA believes that the registered entities need the ability to respond flexibly and decisively in response to an emergency. FIA accordingly recommends that the Commission not impose limits on the ability of the registered entities to respond as may be necessary to the unforeseen circumstances of an emergency situation.

  FIA is nonetheless concerned that a registered entity and, in particular, a DCO could cite an emergency event as the grounds for a fundamental recasting of the responsibilities of the members of the registered entity. Thus, while FIA believes that the registered entities do need the ability to respond flexibly to emergency situations, FIA also believes that the registered entities should not be given carte blanche to rewrite their rules and, with them, the obligations of their members just because of the occurrence of an emergency. FIA accordingly recommends that proposed Commission Regulation 40.6(a)(6)(i), relating to the prior submission of rules setting forth standards for responding to an emergency, be amended to make clear that any such rules must not only describe the circumstances that may give rise to a declaration of an emergency but, more importantly, broadly identify the actions the registered entity is prepared to take – and, where appropriate, is prepared to forego – in response to an emergency.[11]

- FIA further suggests that proposed Commission Regulation 40.6(a)(7)(v) be modified to allow a registered entity to submit the documentation that it has relied upon to establish the basis for compliance with applicable provision of the Act and Commission Regulations , after the resolution of an emergency. FIA makes this latter recommendation in light of its recognition that the exigencies of an emergency will likely not permit a registered entity sufficient time to document in writing its evaluation of its compliance with the Act, including the Core Principles, and that requiring it to do so could result in a hurried presentation of complex information in a manner that could later be used to the detriment of the registered entity in private litigation brought by parties who allege that they were harmed by the emergency action.

- Finally, FIA urges the Commission to refine its definition of the term "rule" to clarify that "Advisories," "Interpretations" and similar communications that are issued by the

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10 75 Fed. Reg. 67282, 67288 (November 2, 2010).

11 FIA further recommends that the proposed Regulations be further amended to permit a registered entity to submit those rules for Commission approval under Regulation 40.5, as well as by self-certification under Regulation 40.6(a).

registered entities are, in appropriate circumstances, "rules" that are fully subject to the requirements of the Part 40 Regulations. It is one thing for a registered entity to issue guidance as to the interpretation of one of its rules; notices of this nature alert the membership and the public to what is (or is not) considered acceptable and are entirely appropriate. It is quite another thing, however, to issue new mandates, or enlarge upon what is set forth in the terms of an existing rule, under the guise of an "interpretation."[12] FIA accordingly recommends that the Commission consider the approach that is employed by the SEC under its comparable regulation, which brings "stated policies, practices and interpretations" of a securities self-regulatory organization within the scope of the term "rule." SEC Rule 19b-4 (17 C.F.R. § 240.19b-4) further defines the term "stated policy, practice, or interpretation" and goes on to provide that they are "rules" unless they are reasonably and fairly implied by an existing rule of the self-regulatory organization or relate solely to the administration of the self-regulatory organization. FIA believes that adoption of a similar approach by the Commission would minimize the circumvention of the Commission's rule review authority and allow the Commission to exercise in a uniform and consistent manner the authority granted by Congress under Section 5c of the Act.

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FIA appreciates the opportunity to submit these comments regarding the financial resource requirements for DCOs. If the Commission has any questions concerning the matters discussed in this letter, please contact Barbara Wierzynski, FIA's Executive Vice President and General Counsel, at (202) 466-5460.

Sincerely,

John M. Damgard
President

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12 As an example, the Joint Audit Committee ("JAC") has long interpreted Commission Regulation 30.7 to require futures commission merchants ("FCMs") to invest foreign futures "secured amount" funds in a manner consistent with the requirements for customer segregated funds under Commission Regulation 1.25. That may be sound public policy, but it is not what is required by the Commission's own regulations. FCMs, of course, have no choice but to comply with that "interpretation," notwithstanding the fact that the JAC's guidance was never the subject of a rule filing with the Commission. FIA accordingly recommends that the Commission take this opportunity to remind members of the JAC that they are obligated to ensure that JAC "interpretations" are rules of the respective members of the JAC as surely as if those interpretations had been adopted and promulgated by the members of the JAC itself.

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

Division of Market Oversight
Bella Rozenberg, Special Counsel
Riva Spear Adriance, Associate Director for Market Review